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Letters for underwriters; Statement on auditing standards, 038

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Statement on Auditing Standards

April 1981

38

Issued by the Auditing Standards Executive Committee

AICPA

American Institute of
Certified Public Accountants

Letters for Underwriters

1. The services of independent certified public accountants include examination of financial statements and schedules contained in registration statements filed with the Securities and Exchange Commission (the SEC) under the Securities Act of 1933 (the Act). In connection with this type of service, accountants often are called upon to confer with clients, underwriters, and their respective counsel concerning the accounting and auditing requirements of the Act and of the SEC, as well as to perform other services. One of these other services is the issuance of letters for underwriters, commonly called *comfort letters*, which are generally concerned with the subjects described in paragraph 6.

2. Much of the uncertainty and consequent risk of misunderstanding with regard to the nature and scope of comfort letters has arisen from a lack of recognition of the necessarily limited nature of the comments that accountants can properly make with respect to financial information, in a registration statement, that has not been examined in conformity with generally accepted auditing standards and accordingly is not covered by their opinion. Underwriters, in requesting comfort letters, are generally seeking assistance on matters of importance to them. They wish to perform a "reasonable investigation"

Note: This Statement supersedes Statement on Auditing Standards No. 1, section 630, "Letters for Underwriters." The changes are in response to revisions of reporting requirements under regulations of the Securities and Exchange Commission and changes in professional standards relating primarily to reviews of interim financial information.

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of financial and accounting data not “expertized” (covered by a report of independent accountants, who consent to be named as experts, based on an examination made in accordance with generally accepted auditing standards) as a defense against possible claims under the Act. Accountants have a corresponding wish, arising in response to the same statutory phrase, *reasonable investigation*, with respect to audited financial statements included in a prospectus in reliance on their audit report and their consent.¹ The accountants’ reasonable investigation must be premised upon an audit; it cannot be accomplished short of an audit. What constitutes a reasonable investigation of unaudited financial information sufficient to satisfy an underwriter’s purposes has never been authoritatively established. Consequently, only the underwriter can determine what is sufficient for his purposes. Accountants will normally be willing to assist the underwriter, but the assistance accountants can provide by way of comfort letters is subject to limitations. One limitation is that an independent accountant can properly comment in his professional capacity only on matters to which his professional expertise is substantially relevant. Another limitation is that procedures short of an audit, such as those contemplated in a comfort letter, provide the accountant with a basis for expressing, at the most, negative assurance.² Such limited procedures may bring to the accountant’s attention significant matters affecting the financial information, but they do not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an audit. Accordingly, there is necessarily a risk that the conditions or matters about which the auditor has provided negative assurance of their absence may prove to have existed.

3. This Statement deals with several different kinds of matters. First, in a number of areas involving professional standards, it states whether or not it is proper for independent certified public accountants acting in their professional capacity to comment on specified kinds of matters, and, if so, what the form of comment should be.

¹See SAS No. 37 for a discussion of certain responsibilities of accountants resulting from inclusion of their reports in registration statements.

²Negative assurance consists of a statement by accountants to the effect that, as a result of specified procedures, nothing came to their attention that caused them to believe that specified matters do not meet a specified standard (e.g., that unaudited financial statements or condensed financial statements were not prepared in conformity with generally accepted accounting principles consistently applied).

Second, suggestions of a practical nature are offered on such matters as forms of comfort letters suitable to various circumstances, the way in which a particular form of letter may be agreed upon, the dating of letters, and what steps may be taken when information that may require special mention in a letter comes to the accountants' attention.³ Third, ways are suggested to reduce or avoid the uncertainties described in the preceding paragraph regarding the nature and extent of accountants' responsibilities in connection with a comfort letter. In regard to this and other points not involving professional standards, where the recommendations are intended to reduce risks of misunderstanding, accountants requested to follow a course other than that recommended would do well to consult their counsel.

4. Comfort letters are not required under the Act, and copies are not filed with the SEC. It is nonetheless a common condition of an underwriting agreement in connection with the offering for sale of securities registered with the SEC under the Act that the accountants are to furnish a comfort letter. Some underwriters do not make the receipt of a comfort letter a condition of the underwriting agreement but nevertheless ask for such a letter.⁴

5. The accountants should suggest to the underwriter that they meet together with the client to discuss the procedures to be followed in connection with a comfort letter; in this connection, the accountants may describe procedures frequently followed (see examples included at the end of this Statement, paragraphs 47 through 56). Because of the accountants' knowledge of the client, such a meeting may substantially assist the underwriter in reaching his decision about the procedures to be followed by the accountants. However, it is still advisable to accompany any discussion of procedures with a clear

³It is important to note that although the illustrations in this Statement describe procedures that are frequently followed by accountants as a basis for their comments in comfort letters, it does not prescribe such procedures.

⁴Except where the context otherwise requires, the word *underwriter*, as used in this Statement, refers to the managing, or lead, underwriter, who typically negotiates the underwriting agreement for a group of underwriters whose exact composition is not determined until shortly before a registration statement becomes effective. In competitive bidding situations where legal counsel for the underwriters acts as the underwriters' representative prior to the opening and acceptance of the bid, the accountants should carry out the discussions and other communications contemplated by this Statement with the legal counsel until the underwriter is selected.

statement that the accountants cannot furnish any assurance regarding the sufficiency of the procedures for the underwriter's purposes, and it is advisable for the comfort letter to contain a statement to this effect. An appropriate way of expressing this is shown in numbered paragraph 4 of example A.

6. Comfort letters will generally refer to one or more of the following subjects:

- a. The independence of the accountants.
- b. Compliance in form in all material respects of the audited financial statements and schedules included in the registration statement with the applicable accounting requirements of the Act and the published rules and regulations thereunder.⁵
- c. Unaudited financial statements or condensed financial statements included in the registration statement.
- d. Changes in selected financial-statement items during a period subsequent to the date and period of the latest financial statements included in the registration statement.
- e. Tables, statistics, and other financial information included in the registration statement.

These matters are discussed in greater detail below and are illustrated in the examples included at the end of this Statement. Matters dealt with in a particular letter usually are limited to ones specified in the underwriting agreement.

7. Because the underwriter will expect the accountants to furnish a comfort letter of a scope to be specified in the underwriting agreement, the client and the underwriter, when they have tentatively agreed upon a draft of the agreement, are well advised to furnish a copy of it to the accountants so that the latter can indicate whether they will be able to furnish a letter in acceptable form. A desirable practice is for the accountants, promptly after they have received the draft of the agreement (or have been informed that a letter covering specified matters, although not a condition of the agreement, will nonetheless be requested), to prepare a draft of the form of letter that they expect to furnish. To the extent possible, the draft should deal

⁵ Financial information included in a registration statement also includes information incorporated in the registration statement by reference.

with all matters to be covered in the exact terms to be used in the final letter (subject, of course, to the understanding that the comments in the final letter cannot be determined until the procedures underlying it have been performed). The draft letter should be identified as a draft in order to avoid giving the impression that the procedures described therein have been performed. This practice of furnishing a draft letter at an early point permits the accountants to make clear to the client and the underwriter what they may expect the accountants to furnish and gives the client and the underwriter an opportunity to change the proposed underwriting agreement if they so desire. The underwriter thus furnished with a draft letter is afforded the opportunity to discuss further with the accountants the procedures that the accountants have indicated they expect to follow, and to request any additional procedures that the underwriter may desire. If the additional procedures pertain to matters to which the accountants' professional competence is relevant, the accountants would ordinarily be willing to perform them, and it is desirable for them to furnish the underwriter with an appropriately revised draft letter. The accountants may reasonably assume that the underwriter, by indicating his acceptance of the draft comfort letter, and subsequently, by his acceptance of the letter in final form, considers the procedures described sufficient for his purposes. It is important, therefore, that the procedures to be followed by the accountants be clearly set out in the comfort letter, in both draft and final form, so that there will be no misunderstanding about the basis upon which the accountants' comments have been made and so that the underwriter can decide whether the procedures performed are sufficient for his purposes. For reasons explained in paragraph 2, statements or implications that the accountants are carrying out such procedures as they consider necessary should be avoided since this may lead to misunderstanding about the responsibility for the sufficiency of the procedures for the underwriter's purposes. A suggested form of legend that may be placed on the draft letter for identification and explanation of its purposes and limitations is as follows:

This draft is furnished solely for the purpose of indicating the form of letter that we would expect to be able to furnish [name of underwriter] in response to their request, the matters expected to be covered in the letter, and the nature of the procedures that we would expect to carry out with respect to such matters. Based on our discussions with [name of underwriter], it is our understanding that the

procedures outlined in this draft letter are those they wish us to follow.⁶ Unless [name of underwriter] informs us otherwise, we shall assume that there are no additional procedures they wish us to follow. The text of the letter itself will depend, of course, upon the results of the procedures, which we would not expect to complete until shortly before the letter is given and in no event before the cutoff date indicated therein.

Dating

8. The letter ordinarily is dated at or shortly before the *closing date* (the date on which the issuer or selling security holder delivers the securities to the underwriter in exchange for the proceeds of the offering). The underwriting agreement ordinarily specifies the date, often referred to as the *cutoff date*, to which the letter is to relate (for example, a date five business days before the date of the letter); the accountants should see that the cutoff date will not place an unreasonable burden on them. The letter should state that the inquiries and other procedures carried out in connection with the letter did not cover the period from the cutoff date to the date of the letter.

9. Letters may also be dated at or shortly before the *effective date* (the date on which the registration statement becomes effective); and, on rare occasions, letters have been requested to be dated at or shortly before the *filing date* (the date on which the registration statement is first filed with the SEC). If more than one letter is requested, it will be necessary to carry out the specified procedures and inquiries as of the cutoff date for each letter. Although comments contained in an earlier letter may on occasion conveniently be incorporated by reference in a subsequent letter (see example C), any subsequent letter should relate only to information in the registration statement as most recently amended.

⁶In the absence of any discussions with the underwriter, the accountants should outline in the draft letter those procedures specified in the underwriting agreement that they are willing to perform. In that event, this sentence should be revised as follows: "In the absence of any discussions with [name of underwriter], we have set out in this draft letter those procedures referred to in the draft underwriting agreement (of which we have been furnished a copy) that we are willing to follow."

Addressee

10. Because the letter is a result of the underwriter's request, many accountants address the letter only to the underwriter, with a copy furnished to the client. When this is done, the appropriate addressee is the underwriter who has negotiated the underwriting agreement with the client, and with whom the accountants will deal in discussions regarding the scope and sufficiency of the letter, rather than the group of underwriters for whom that underwriter acts as representative.⁷ Some accountants address the letter instead to the client, or to both the client and the underwriter. If the accountants are requested to address the letter to any person other than the underwriter or the client, they should consider consulting their legal counsel.

Introductory Paragraph

11. It is desirable to include an introductory paragraph substantially as follows:

We have examined the [identify the financial statements and schedules examined] included [incorporated by reference] in the registration statement (no. 2-00000) on Form _____ filed by the company under the Securities Act of 1933 (the Act); our reports with respect thereto are also included [incorporated by reference] in that registration statement. The registration statement, as amended as of _____, is herein referred to as the registration statement.

Independence

12. It is customary for the underwriting agreement to provide for the accountants to make a statement concerning their independence in the letter. This may be done substantially as follows:

We are independent certified public accountants with respect to The Blank Company, Inc., within the meaning of the Act and the

⁷ An appropriate form of address for this purpose is "XYZ & Company, as Representative of the Several Underwriters."

applicable published rules and regulations thereunder, and the answer to [identify the item number that refers to the relationship with registrant of experts named in the registration statement, e.g., item 23 of Form S-1] of the registration statement is correct insofar as it relates to us.

(See paragraph 34 regarding instances wherein the accountants' client is not the registrant.)

Compliance With SEC Requirements

13. The accountants may be requested to express an opinion concerning compliance as to form of the financial statements covered by their report with the pertinent published accounting requirements of the SEC.⁸ This may be done substantially as follows:

In our opinion [include phrase, "except as disclosed in the registration statement," if applicable], the [identify the financial statements and schedules examined] examined by us and included or incorporated by reference in the registration statement comply in form in all material respects with the applicable accounting requirements of the Act and the published rules and regulations thereunder.⁹

If there is a material departure from the pertinent published requirements, the departure should be disclosed in the letter. Normally, representatives of the SEC will have agreed to such a departure; when this occurs, the agreement should be men-

⁸The word *published* is used because accountants should not be expected to be familiar with, or express assurances as to compliance with, informal requirements that have not been published by the SEC but that may be applied by the SEC staff.

⁹Certain financial statements may be incorporated in a registration statement under the Securities Act of 1933 by reference to filings under the Securities Exchange Act of 1934. In those circumstances, the accountants may refer to compliance in form in all material respects of the audited financial statements and schedules included or incorporated by reference in the registration statement with the applicable accounting requirements of the Securities Exchange Act of 1934 and the related published rules and regulations (see example J). However, the accountants should not refer to compliance with the provisions of the 1934 act regarding internal accounting control. (See the October 1978 auditing interpretation, *Compliance with the Foreign Corrupt Practices Act of 1977* (AU section 9642.10-.13).)

tioned in the comfort letter.¹⁰ An appropriate manner of doing this is shown in example D.

14. Since published SEC requirements do not deal with the form of pro forma financial statements or pro forma adjustments applied to historical financial statements, there is no basis for accountants to comment on whether such pro forma information complies in form with SEC requirements (see also paragraph 18 g).

Accountants' Reports

15. Underwriters occasionally request the accountants to repeat in the comfort letter their opinion on the audited financial statements included in the registration statement. Because of the special significance of the date of an accountants' report, the accountants should not repeat their opinion.¹¹ Underwriters sometimes request negative assurance regarding the accountants' opinion. Because accountants have a statutory responsibility with respect to their opinion as of the effective date, and because the additional significance, if any, of negative assurance is unclear and such assurance may therefore give rise to misunderstanding, it is inadvisable to give such negative assurance. Also, the accountants should not give negative assurance with respect to financial statements and schedules that have been examined and are reported on in the registration statement by other accountants.

16. An underwriter may also request the accountants to comment in their comfort letter on (a) unaudited interim financial information required by item 12(a) of SEC Regulation S-K, to which SAS No. 36 relates, or (b) required supplementary information, to which SAS No. 27 relates. SAS Nos. 27 and 36 provide that the accountant should

¹⁰Departures from published SEC requirements that require mention in a comfort letter ordinarily do not affect fair presentation in conformity with generally accepted accounting principles; however, if they do, the accountants will of course take cognizance of these departures in expressing their opinion and in consenting to the use of their report in the registration statement. If departures from published SEC requirements that require mention in a comfort letter either are not disclosed in the registration statement or have not been agreed to by representatives of the SEC, the accountants should consider carefully the issuance of a consent to the use of their report in the registration statement.

¹¹ See SAS No. 1, paragraphs 530.03—.08.

expand his standard report on the audited financial statements to refer to such information when the scope of his procedures with regard to the information was restricted or when the information appears not to be presented in conformity with generally accepted accounting principles or (for required supplementary information) applicable guidelines. Such expansions of the accountants' standard report in the registration statement would ordinarily be referred to in the opening paragraph of the comfort letter (see paragraphs 30 through 33). Additional comments on such unaudited information are therefore unnecessary. However, if the underwriter requests the accountants to perform procedures with regard to such information in addition to the procedures performed in connection with the audit as prescribed by SAS Nos. 27 and 36, the accountants may do so and report their findings.

17. The accountants may refer in the introductory paragraphs of the comfort letter to the fact that a review had been performed of interim financial information. Such a reference should be to the accountants' report that was previously issued on the interim financial information, and that report may be attached to the comfort letter. The accountants should not, however, repeat their report in the comfort letter or otherwise imply that they are reporting on the interim financial information as of the date of the comfort letter, for to do so might extend the accountants' responsibility for their report to the date of the comfort letter or imply that the accountants assume responsibility for the sufficiency of the procedures for the underwriter's purposes.

Unaudited Condensed Financial Statements, Capsule Information, and Subsequent Changes

In General

18. Comments included in the letter will often concern (1) unaudited condensed financial statements included in the registration statement (see paragraphs 19 and 20),¹² (2) capsule information (see

¹²The SEC requirements specify condensed financial statements. However, the guidance in paragraphs 18 through 20 also applies to complete financial statements.

paragraphs 21 and 22), (3) changes in capital stock and long-term debt, (4) decreases in other specified financial-statement items (see paragraphs 23 through 28), and (5) pro forma financial statements. In commenting on these matters, the following guides are important:

- a. Any statements by the accountants with respect to unaudited condensed financial statements, capsule information, and subsequent changes or decreases should be limited to negative assurance. An appropriate manner of expressing the comments is shown in numbered paragraph 5 of example A.
- b. As explained in paragraph 7, the agreed-upon procedures performed by the accountants should be set forth in the letter. Such procedures are generally described along the lines of numbered paragraph 4 of example A.
- c. To avoid any misunderstanding about the responsibility for the sufficiency of the agreed-upon procedures for the underwriter's purposes, the accountants should not make any statements or imply that they have applied procedures that they have determined to be necessary or sufficient for the underwriter's purposes. In this respect, the underwriter may request the accountants to perform procedures similar to those in SAS No. 36, paragraph 6. However, for the accountants to include such procedures in their letter, the underwriter would have to provide sufficiently specific criteria so that there is no implication that the responsibility for the sufficiency of the agreed-upon procedures has been assumed by the accountants. For example, if the underwriter requests the accountants to apply analytical review procedures and specifies items of financial information to be reviewed and the materiality level for changes in those items that would necessitate further inquiry by the accountants, the accountants may refer to those procedures in their letter. Descriptions of procedures in the comfort letter should include descriptions of the criteria specified by the underwriter.
- d. Terms of uncertain meaning, such as *general review*, *limited review*, *check*, or *test*, should not be used in describing the work, unless the procedures comprehended by the term are described in the comfort letter.
- e. The letter should specifically identify any unaudited condensed financial statements and should state that the accountants have

not examined the condensed financial statements, in accordance with generally accepted auditing standards, and do not express an opinion concerning them. An appropriate manner of making this clear is shown in numbered paragraph 3 of example A (see also paragraph 20).

- f. The accountants should not give negative assurance with respect to unaudited condensed financial statements, capsule information, or changes or decreases unless they have obtained knowledge of the client's accounting and financial reporting practices and its system of internal accounting control relating to the preparation of financial statements. An understanding of the client's practices in preparing its most recent annual financial statements provides a practical basis for the accountants' inquiries or procedures. Ordinarily, accountants obtain such an understanding in auditing the client's financial statements for one or more annual periods. However, if for whatever reason the accountants have not conducted such an audit, the need for an understanding of the client's accounting and financial reporting practices and its system of internal accounting control is not diminished, and the accountants should consider whether, under the particular circumstances, they can acquire sufficient knowledge of these matters to perform the inquiries and procedures requested by the underwriter.
- g. The accountants should not give negative assurance on pro forma adjustments applied to historical financial statements unless (1) they have made an examination of the entity's historical financial statements (or, in the case of business combinations, of a significant constituent part of the combined financial statements) (a) for the period presented or (b) in the case of interim periods for the latest fiscal period that includes or precedes the interim period, or (2) they have otherwise obtained knowledge of the client's accounting and financial reporting practices and its system of internal accounting control as provided for in *f* above.
- h. The procedures followed with respect to interim periods may not disclose changes in capital stock or long-term debt or decreases in the specified financial-statement items, inconsistencies in the application of generally accepted accounting principles, instances of noncompliance in form with accounting requirements of the SEC, or other matters about which negative assurance is

requested. An appropriate manner of making this clear is shown in the last three sentences in paragraph 4 of example A.

- i. The working papers relating to comfort letters should be prepared in such a manner that they constitute adequate evidence of what has been done.

Unaudited Condensed Financial Statements

19. Comments in the comfort letter concerning the unaudited condensed financial statements appearing in the registration statement should always be made in the form of negative assurance.¹³ Frequently, such comments relate to (a) conformity with generally accepted accounting principles, (b) consistency with the audited financial statements included in the registration statement, and (c) compliance in form with applicable accounting requirements. An appropriate manner of expressing the comments is shown in numbered paragraph 5a of example A.

20. When the most recent figures included in a condensed statement of income are for a period of less than one year, the SEC requires that comparative figures be shown for the corresponding short period of the preceding year. The condensed financial statements for the latest interim period and the preceding year are ordinarily unaudited. In these circumstances, the unaudited status of the condensed financial statements should be made clear in the comfort letter (see numbered paragraph 3 of example A and paragraph 18e).

Capsule Information

21. In some registration statements the information shown in the audited financial statements or unaudited interim condensed financial statements is supplemented by unaudited summarized interim information for subsequent periods (commonly called *capsule information*). This capsule information (either in narrative or tabular form) is often provided for the most recent interim period and for the corresponding period of the prior year. With regard to selected capsule information, the accountants

¹³ See SAS No. 26, paragraphs 18 through 20.

- a. May give negative assurance in regard to conformity with generally accepted accounting principles and may refer to whether the dollar amounts were determined on a basis substantially consistent with that of the corresponding amounts in the audited financial statements if the selected capsule information is presented in accordance with the minimum disclosure requirements of APB Opinion No. 28, paragraph 30 (see example J), or
- b. May refer only to whether the dollar amounts were determined on a basis substantially consistent with that of the corresponding amounts in the audited financial statements if the selected capsule information is more limited than the minimum disclosures described in APB Opinion No. 28, paragraph 30 (see example E).

22. The underwriter occasionally asks the accountants to give negative assurance with respect to the unaudited financial statements that underlie the capsule information and to state that the capsule information agrees with amounts set forth in such statements. If the underwriter requests it, and if it is practicable for the client to prepare such financial statements on a timely basis in conformity with generally accepted accounting principles, it is appropriate for the accountants to agree to the underwriter's request. Paragraphs 4*b* and 5*b* in example E provide an example of the accountants' comments in these circumstances.

Subsequent Changes

23. Comments regarding subsequent changes also should be in the form of negative assurance. They should not relate to "adverse changes" since, despite long use, that term has not acquired any defined or clearly understood meaning in an accounting sense. In fact, underwriters occasionally may have misinterpreted that term as encompassing judgments and conclusions not contemplated by the accountants. For example, there has been no agreement among accountants, clients, and underwriters regarding whether the term relates only to absolute changes or also includes trends in amounts or ratios. Further, there are differences of view regarding whether an adverse change in results of operations is indicated solely by a decrease in net income or whether it also encompasses changes in sales, cost of sales, and other factors, which separately or together might indicate the beginning or accentuation of an adverse trend. Also, the

term has sometimes been construed as contemplating comments by accountants regarding matters to which their professional competence has little relevance, such as evaluating whether certain types of expenses that may decrease current income but are designed to increase future income (for example, research and development costs, major advertising campaigns, and systems installations) are adverse or not. In order that comments on subsequent changes be unambiguous and their determination be within the professional competence of accountants, the comments should not relate to adverse changes but should ordinarily relate to whether there has been any change in capital stock or long-term debt or “decreases” in other specified financial-statement items during a period known as the *change period* (see paragraph 25). Usually these items would include the amounts of net current assets, net assets (stockholders’ equity), and net sales and the total and/or per-share amounts of income before extraordinary items and of net income. An appropriate manner of expressing the comments is shown (a) in numbered paragraph 5b of example A if there has been no decrease and (b) in example F if there has been a decrease.

24. Matters to be covered by the letter should be made clear in the meetings with the underwriter and should be contemplated by the underwriting agreement and in the draft comfort letter. Since there is no way of anticipating other matters that would be of interest to an underwriter, accountants should not make a general statement in comfort letters that, as a result of carrying out the specified procedures, nothing else has come to their attention that would be of interest to the underwriter.

25. In the context of a comfort letter, a decrease occurs when the amount of a financial-statement item at the cutoff date or for the change period (as if financial statements and their notes had been prepared at that date and for that period) is less than the amount of the same item at a specified earlier date or for a specified earlier period. With respect to the items mentioned in paragraph 23, the term *decrease* means (a) any combination of changes in amounts of current assets and current liabilities that results in decreased net current assets, (b) any combination of changes in amounts of assets and liabilities that results in decreased net assets, (c) decreased net sales, and (d) any combination of changes in amounts of sales and expenses

and/or outstanding shares that results in decreased total and/or per-share amounts of income before extraordinary items and of net income (including, in each instance, a greater loss or other negative amount). The change period for which the accountants give negative assurance in the comfort letter ends on the cutoff date (see paragraph 8) and ordinarily begins (a) for balance-sheet items, immediately after the date of the latest balance sheet in the registration statement, and (b) for income-statement items, immediately after the latest period for which such items are presented in the registration statement. The comparison relates to the entire period and not to portions thereof. A decrease during one part of a period may be offset by an equal or larger increase in another part of the period; however, because there was no decrease for the period as a whole, the comfort letter would not report the decrease occurring during one part of the period (see, however, paragraphs 24 and 45).

26. Underwriters occasionally request that the change period begin immediately after the date of the latest audited balance sheet (ordinarily also the closing date of the latest audited statement of income) in the registration statement, even though the registration statement includes a more recent unaudited condensed balance sheet and condensed statement of income. The use of the earlier date may defeat the underwriter's purpose since it is possible that an increase in one of the items referred to in paragraph 23 occurring between the dates of the latest audited and unaudited balance sheets included in the registration statement might more than offset a decrease occurring after the latter date. A similar situation might arise in the comparison of income-statement items. In these circumstances, the decrease occurring after the date of the latest condensed financial statements included in the registration statement would not be reported in the comfort letter. It is desirable for the accountants to explain the foregoing considerations to the underwriter; however, if the underwriter nonetheless requests the use of a change period or periods other than those described in paragraph 25, the accountants may use the period or periods requested.

27. The underwriting agreement usually specifies the dates and periods with which data at the cutoff date and for the change period are to be compared. For balance-sheet items the comparison date is normally that of the latest balance sheet included in the registra-

tion statement (that is, immediately prior to the beginning of the change period). For income-statement items the comparison period or periods might be one or more of the following: (a) the corresponding period of the preceding year, (b) a period of corresponding length immediately preceding the change period, (c) a proportionate part of the preceding fiscal year, or (d) any other period of corresponding length chosen by the underwriter. Whether or not specified in the underwriting agreement, the date and period used in comparison should be identified in the comfort letter in both draft and final form so that there is no misunderstanding about the matters being compared and so that the underwriter can determine whether the comparison period is suitable for his purposes.

28. In addition to making the comparisons indicated above using the financial statements made available to them, the accountants will ordinarily be requested to read minutes and make inquiries of company officials relating to the whole of the change period.¹⁴ For the period between the date of the latest financial statements made available and the cutoff date, the accountants must necessarily base their comments solely on the limited procedures actually performed with respect to that period (which in most cases will be limited to the reading of minutes and the inquiries of company officials referred to in the preceding sentence), and their comfort letter should make this clear (see numbered paragraph 6 of example A).

Disclosure in Registration Statement

29. Comments on the occurrence of changes in capital stock or long-term debt and decreases in other specified financial-statement items are limited to changes or decreases not disclosed in the registration statement. Whenever it appears to the accountants that a change or decrease has occurred during the change period, and the change or decrease is disclosed in the registration statement, the phrase, "except for changes or decreases that the registration statement discloses have occurred or may occur," should be included in the letter.

¹⁴The answers to these inquiries generally should be supported by appropriate written representations of the company officials.

Effect of Qualified Opinion

30. The foregoing discussion contemplates that the accountants' opinion on the financial statements and schedules in the registration statement is unqualified. This usually is the case. Except in extraordinary circumstances, the requirements of the SEC do not permit a registration statement to become effective when the accountants' opinion is qualified in regard to the scope of their examination or the accounting principles reflected in the financial statements and schedules. However, such circumstances do occasionally arise, and, although the SEC may permit the registration statement to become effective even though the opinion is qualified, the accountants may not be in a position to give an unqualified opinion that the financial statements in the registration statement comply in form in all material respects with the published rules and regulations of the SEC under the Act (see paragraph 13).

31. The SEC ordinarily will accept a "subject to" type of qualification in the accountants' opinion when there is uncertainty about the outcome of controversial matters, such as litigation, renegotiation of contracts, disputes concerning income taxes, the proceedings of rate-regulatory commissions, or other matters whose outcomes are not susceptible of reasonable estimation, but which might have a material effect on the financial statements.

32. If the opinion is qualified, the qualification should be referred to in the opening paragraph of the comfort letter by saying, for example, "our reports (which contain a qualification as set forth therein) with respect thereto are also included in the registration statement."¹⁵

33. If the letter includes negative assurance with respect to subsequent unaudited condensed financial statements included in the registration statement or with respect to an absence of specified subsequent changes or decreases, the effect thereon of the subject matter

¹⁵The accountants may also refer in the opening paragraph to expansions of their report that do not affect their opinion, for example, expansions of their report regarding interim financial information accompanying or included in the notes to audited financial statements (see SAS No. 36, paragraphs 29 and 30) or required supplementary information described in SAS No. 27 (see SAS No. 27, paragraphs 8 through 10). See paragraph 16, herein.

of the qualification should also be considered. An illustration of how this type of situation may be dealt with is shown in example G.

Other Accountants

34. Comfort letters are occasionally requested from more than one accountant (for example, in connection with registration statements to be used in the subsequent sale of shares issued in recently effected mergers). In these circumstances, each accountant must, of course, be sure he is independent within the meaning of the Act and the applicable published rules and regulations thereunder. In connection with opinions expressed prior to the acquisitions, the accountants for previously nonaffiliated companies recently acquired by the registrant would not be required to have been independent with respect to the company whose shares are being registered. In such a case, the accountants should modify the wording suggested in paragraph 12 and make a statement regarding their independence along the following lines:

As of [insert date of the accountants' most recent report on the financial statements of their client] and during the period covered by the financial statements on which we reported, we were independent certified public accountants with respect to [insert the name of their client] within the meaning of the Act and the applicable published rules and regulations thereunder, and the answer to item 23 of the registration statement is correct insofar as it relates to us.

35. There may be situations in which more than one accountant is involved in the examination of the financial statements of a business and in which the reports of more than one accountant appear in the registration statement. For example, certain significant divisions, branches, or subsidiaries may be examined by other accountants. The principal accountants (those who report on the consolidated financial statements and consequently are asked to give a comfort letter with regard to information expressed on a consolidated basis) should read the letter or letters of the other accountants reporting on significant units. Such letters should contain statements similar to those contained in the comfort letter prepared by the principal accountants, including statements about their independence. The principal accountants should state in their comfort letter that (a)

reading letters of other accountants was one of the procedures followed, and (b) the procedures performed by the principal accountants (other than reading the letters of the other accountants) relate solely to (1) companies examined by the principal accountants and (2) the consolidated financial statements. An appropriate manner of expressing these comments where the letters of the other accountants do not disclose matters that affect the negative assurance given is shown in example H. If the letters of the other accountants disclose decreases in financial-statement items or any other matters that affect the negative assurance that is given, the principal accountants should mention these matters in their letter. Where appropriate, the principal accountants may comment that there were no decreases in the consolidated financial-statement items despite the decreases mentioned by the other auditors. In such a case, the principal accountants could give negative assurance that nothing had come to their attention regarding the consolidated financial statements as a result of the specified procedures (which, so far as the related company was concerned, consisted solely of reading the other accountants' letter) that caused them to believe that

36. At the earliest practicable date, the client should advise any other accountants who may be involved about any letter that may be required from them and should arrange for them to receive a draft of the underwriting agreement so that they may make arrangements at an early date for the preparation of a draft of their letter (a copy of which should be furnished to the principal accountants) and for the performance of their procedures. In addition, the underwriter may desire to meet with the other accountants for the purposes discussed in paragraph 5.

37. When a comfort letter is furnished to other accountants, it should be addressed in accordance with paragraph 10, and copies should be furnished to the principal accountants and their client. The letter should contain a concluding paragraph similar to the example in paragraph 44.

Tables, Statistics, and Other Financial Information

38. The underwriting agreement sometimes calls for a comfort letter that includes comments on tables, statistics, and other financial information appearing in the registration statement.

39. The accountants should refrain from commenting on matters to which their competence as independent public accountants has little relevance. Accordingly, except as indicated in the next sentence, they should comment only with respect to information (a) that is expressed in dollars (or percentages derived from such dollar amounts) and has been obtained from accounting records that are subject to the internal controls of the company's accounting system or (b) that has been derived directly from such accounting records by analysis or computation. The accountants may also comment on quantitative information that has been obtained from an accounting record if the information is of a type that is subject to the same controls as the dollar amounts. Accountants should not comment on matters involving primarily the exercise of business judgment of management. For example, changes between periods in gross profit ratios or net income may be caused by factors that are not necessarily within the expertise of accountants. The accountants should not comment on matters merely because they happen to be present and are capable of reading, counting, measuring, or performing other functions that might be applicable. Examples of matters that, unless subjected to the internal controls of the formal accounting system (which is not ordinarily the case), should not be commented on by the accountants include square footage of facilities, number of employees (except as related to a given payroll period), and backlog information. The accountants should not comment on tables, statistics, and other financial information relating to an unaudited period unless they have made an examination of the client's financial statements for a period including or immediately prior to the unaudited period or have completed an examination for a later period, or unless they have otherwise obtained knowledge of the client's accounting and financial reporting practices and its system of internal accounting control as provided for in paragraph 18 *f*, herein.

40. As with comments relating to financial statement information, it is important that the procedures followed by the accountants with respect to other information be clearly set out in the comfort letter, in both draft and final form, so that there will be no misunderstanding about the basis of comments on the information. Further, so that there will be no implication that the accountants are furnishing any assurance with respect to the sufficiency of the procedures for the underwriter's intended purpose, it is advisable for the comfort letter

to contain a statement to this effect. An appropriate way of expressing this is shown in numbered paragraph 10 of example I (see also paragraph 7).

41. In order to avoid ambiguity, the specific information commented on in the letter should be identified by reference to captions, tables, page numbers, or specific paragraphs or sentences. It should not refer, for example, to “all financial and statistical information” set forth (a) in the registration statement, (b) under specific captions, or (c) in response to specific item numbers in the registration statement.

42. Comments in the comfort letter concerning tables, statistics, and other financial information included in the registration statement should be made in the form of a description of the procedures followed, the findings (ordinarily expressed in terms of agreement between items compared), and in some cases, as described below, statements with respect to the acceptability of methods of allocation used in deriving the figures commented upon. Whether comments upon the allocation of income or expense items between such categories as military and commercial sales may appropriately be made will depend upon the extent to which such allocation is made in, or can be derived directly by analysis or computation from, the client’s accounting records. In any event, such comments, if made, should make clear that such allocations are to a substantial extent arbitrary, that the method of allocation used is not the only acceptable one, and that other acceptable methods of allocation might produce significantly different results. Furthermore, no comments should be made regarding segment information (or the appropriateness of allocations made to derive segment information) included in financial statements, since the auditor’s report encompasses that information (see SAS No. 21).¹⁶ Appropriate ways of expressing comments on tables, statistics, and other financial information are shown in example I.

43. In comments concerning tables, statistics, and other financial information, the expression *presents fairly* (or a variation of it) should

¹⁶ See paragraph 16, herein, regarding requests by an underwriter for comments on interim financial information required by item 12(a) of SEC Regulation S-K and required supplementary information described in SAS No. 27.

not be used. That expression, when used by independent certified public accountants, ordinarily relates to presentations of financial statements and should not be used in commenting on other types of information. Except with respect to requirements for financial statements, the question of what constitutes appropriate information for compliance with the requirements of a particular item of the registration statement form (for example, whether particular employee benefits constitute management remuneration as defined by SEC regulations) is a matter of legal interpretation outside the competence of the accountants. Consequently, the letter should state that the accountants make no representations regarding any matter of legal interpretation. Since the accountants will not be in a position to make any representations about the completeness or adequacy of disclosure or about the adequacy of the procedures followed, the letter should so state. It should point out as well that such procedures would not necessarily disclose material misstatements or omissions in the information to which the comments relate. An appropriate manner of expressing the comments is shown in example I.

Concluding Paragraph

44. In order to avoid misunderstanding of the purpose and intended use of the comfort letter, it is desirable that the letter conclude with a paragraph along the following lines:

This letter is solely for the information of, and assistance to, the underwriters¹⁷ in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the registration statement, and it is not to be used, circulated, quoted, or otherwise referred to within or without the underwriting group for any other purpose, including, but not limited to, the registration, purchase, or sale of securities, nor is it to be filed with or referred to in whole or in part in the registration statement or any other document, except that reference may be made to it in the underwriting agreement or in any list of closing documents pertaining to the offering of the securities covered by the registration statement.

¹⁷When the letter is furnished by the accountants for a subsidiary who are not accountants for the parent company, it should include at this point the following phrase: "and for the use of the accountants for [name of issuer] in furnishing their letter for the underwriters."

Miscellaneous

45. Accountants who discover matters that may require mention in the final comfort letter but that are not mentioned in the draft letter that has been furnished to the underwriter, such as decreases or changes in specified items not disclosed in the registration statement (see paragraphs 23 and 29), will naturally want to discuss them with their client so that consideration can be given to whether disclosure should be made in the registration statement. If disclosure is not to be made, the accountants should inform the client that the matters will be mentioned in the comfort letter and should suggest that the underwriter be promptly informed. It is recommended that the accountants be present when such matters are discussed between the client and the underwriter.

Examples

46. The contents of letters for underwriters vary, depending on the extent of the information in the registration statement and the wishes of the underwriter. The following are examples of letters for underwriters, or portions of such letters.

Example A: Typical Letter

47. The matters covered in a typical comfort letter are described below:

- a. A statement regarding the independence of the accountants (paragraph 12).
- b. An opinion regarding whether the audited financial statements and schedules included in the registration statement comply in form in all material respects with the applicable accounting requirements of the Act and the published rules and regulations thereunder (paragraph 13).
- c. Negative assurance with respect to whether the unaudited condensed financial statements included in the registration statement (paragraphs 18 through 20)
 - i. Comply in form with the applicable accounting requirements of the Act and the related published rules and regulations.
 - ii. Are fairly presented in conformity with generally accepted

accounting principles on a basis substantially consistent with that of the audited financial statements and schedules included in the registration statement.

- d. Negative assurance with respect to whether, during a specified period following the date of the latest financial statements in the registration statement and prospectus, there has been any change in capital stock or long-term debt or any decrease in other specified financial-statement items (paragraphs 18 and 23–28).

Example A is a letter covering all these items. Letters that cover some of the items may be developed by omitting inapplicable portions of example A.

Example A assumes the following circumstances.¹⁸ The prospectus (part I of the registration statement) includes audited consolidated balance sheets as of December 31, 19X5 and 19X4, and audited consolidated statements of income, retained earnings, and changes in financial position for each of the three years in the period ended December 31, 19X5. Part I also includes an unaudited consolidated condensed balance sheet as of March 31, 19X6, and consolidated condensed statements of income, retained earnings, and changes in financial position for the three-month periods ended March 31, 19X6 and 19X5, which were reviewed by the independent accountants and their review report was dated May 15, 19X6. Part II of the registration statement includes consolidated financial schedules for the three years ended December 31, 19X5 (audited). The effective date is June 23, 19X6. The cutoff date is June 25, 19X6, and the letter is dated June 30, 19X6.

Each of the comments in the letter is in response to a requirement of the underwriting agreement. For purposes of example A, the income-statement items of the current interim period are to be compared with those of the corresponding period of the preceding year.

June 30, 19X6

[Addressee]

Dear Sirs:

We have examined the consolidated balance sheets of The Blank Company, Inc. (the company) and subsidiaries as of December 31,

¹⁸The example includes financial statements required by SEC regulations to be included in the filing. If additional financial information is covered by the comfort letter, appropriate modifications should be made.

19X5 and 19X4, and the consolidated statements of income, retained earnings, and changes in financial position for each of the three years in the period ended December 31, 19X5, and the related schedules all included in the registration statement (no. 2-00000) on Form S-1 filed by the company under the Securities Act of 1933 (the Act); our reports with respect thereto are also included in the registration statement. The registration statement, as amended on June 23, 19X5, is herein referred to as the registration statement.¹⁹

In connection with the registration statement:

1. We are independent certified public accountants with respect to The Blank Company, Inc., within the meaning of the Act and the applicable published rules and regulations thereunder, and the answer to item 23 of the registration statement is correct insofar as it relates to us.

2. In our opinion [include the phrase “except as disclosed in the registration statement,” if applicable], the consolidated financial statements and schedules examined by us and included in the registration statement comply in form in all material respects with the applicable accounting requirements of the Act and the related published rules and regulations.

3. We have not examined any financial statements of the company as of any date or for any period subsequent to December 31, 19X5; although we have made an examination for the year ended December 31, 19X5, the purpose (and therefore the scope) of the examination was to enable us to express our opinion on the consolidated financial statements as of December 31, 19X5, and for the year then ended, but not on the financial statements for any interim period within that year. Therefore, we are unable to and do not express any opinion on the unaudited consolidated condensed balance sheet, as of March 31, 19X6, and interim consolidated condensed statements of income, retained earnings, and changes in financial position for the three-month periods ended March 31, 19X6 and 19X5, included in the registration statement, or on the financial position, results of operations, or changes in financial position as of any date or for any period subsequent to December 31, 19X5.

4. For purposes of this letter we have read the 19X6 minutes of meetings of the stockholders, the board of directors, and [include other appropriate committees, if any] of the company and its subsidiaries as set forth in the minute books at June 25, 19X6, officials of the company

¹⁹If the auditor refers to the fact that a review of interim financial information had been performed, an additional introductory paragraph, such as the following, may be added:

Also, we have made a review of the unaudited condensed interim financial statements for the three-month periods ended March 31, 19X6 and 19X5, as indicated in our report dated May 15, 19X6.

having advised us that the minutes of all such meetings through that date were set forth therein; and have carried out other procedures to June 25, 19X6 (our work did not extend to the period from June 26, 19X6, to June 30, 19X6, inclusive), as follows:

- a. With respect to the three-month periods ended March 31, 19X6 and 19X5, we have
 - i. Read the unaudited consolidated condensed balance sheet as of March 31, 19X6, and unaudited consolidated condensed statements of income, retained earnings, and changes in financial position for the three-month periods ended March 31, 19X6 and 19X5, included in the registration statement; and
 - ii. Made inquiries of certain officials of the company who have responsibility for financial and accounting matters regarding (1) whether the unaudited consolidated condensed financial statements referred to under *a(i)* comply in form in all material respects with the applicable accounting requirements of the Act and the published rules and regulations thereunder and (2) whether those consolidated condensed financial statements are fairly presented in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements included in the registration statement.
- b. With respect to the period from April 1, 19X6, to May 31, 19X6, we have
 - i. Read the unaudited consolidated financial statements of the company and subsidiaries for April and May of both 19X5 and 19X6 furnished us by the company, officials of the company having advised us that no such financial statements as of any date or for any period subsequent to May 31, 19X6, were available; and
 - ii. Made inquiries of certain officials of the company who have responsibility for financial and accounting matters regarding whether the unaudited financial statements referred to under *b(i)* are stated on a basis substantially consistent with that of the audited financial statements included in the registration statement.

The foregoing procedures do not constitute an examination made in accordance with generally accepted auditing standards. Also, they would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representations regarding the sufficiency of the foregoing procedures for your purposes.

5. Nothing came to our attention as a result of the foregoing procedures, however, that caused us to believe that

- a. (i) The unaudited consolidated condensed financial statements described in 4a(i), included in the registration statement, do not comply in form in all material respects with the applicable accounting requirements of the Act and the related published rules and regulations; and (ii) the unaudited consolidated condensed financial statements are not fairly presented in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements; or
- b. (i) At May 31, 19X6, there was any change in the capital stock or long-term debt of the company and subsidiaries consolidated or any decreases in consolidated net current assets or net assets as compared with amounts shown in the March 31, 19X6 unaudited consolidated condensed balance sheet included in the registration statement; or (ii) for the period from April 1, 19X6, to May 31, 19X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in the total or per-share amounts of income before extraordinary items or of net income, except in all instances for changes or decreases that the registration statement discloses have occurred or may occur.

6. As mentioned under 4b, company officials have advised us that no consolidated statements as of any date or for any period subsequent to May 31, 19X6, are available; accordingly, the procedures carried out by us with respect to changes in financial-statement items after May 31, 19X6, have, of necessity, been even more limited than those with respect to the periods referred to in 4. We have made inquiries of certain company officials who have responsibility for financial and accounting matters regarding whether (i) there was any change at June 25, 19X6, in the capital stock or long-term debt of the company and subsidiaries consolidated or any decreases in consolidated net current assets or net assets as compared with amounts shown on the March 31, 19X6, unaudited consolidated condensed balance sheet included in the registration statement; or (ii) for the period from April 1, 19X6, to June 25, 19X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in the total or per-share amounts of income before extraordinary items or of net income. On the basis of these inquiries and our reading of the minutes as described in 4, nothing came to our attention that caused us to believe that there was any such change or decrease, except in all instances for changes or decreases that the registration statement discloses have occurred or may occur.

7. This letter is solely for the information of, and assistance to, the

underwriters in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the registration statement, and it is not to be used, circulated, quoted, or otherwise referred to within or without the underwriting group for any other purpose, including but not limited to the registration, purchase, or sale of securities, nor is it to be filed with or referred to in whole or in part in the registration statement or any other document, except that reference may be made to it in the underwriting agreement or in any list of closing documents pertaining to the offering of the securities covered by the registration statement.

Example B: Alternate Wording of the Letter for Companies That Are Permitted to Present Interim Earnings Data for a Twelve-Month Period

48. Certain types of companies are permitted to include earnings data for a twelve-month period to the date of the latest balance sheet furnished in lieu of earnings data for both the interim period between the end of the latest fiscal year and the date of the latest balance sheet and the corresponding period of the preceding fiscal year. The following would be substituted for the applicable part of numbered paragraph 3 of example A.

3. . . . was to enable us to express our opinion on the financial statements as of December 31, 19X5, and for the year then ended, but not on the financial statements for any period included in part within that year. Therefore, we are unable to and do not express any opinion on the unaudited consolidated condensed balance sheet as of March 31, 19X6, and the related consolidated condensed statements of income, retained earnings, and changes in financial position for the twelve months then ended included in the registration statement. . . .

Example C: Letter Reaffirming Comments in Example A as of a Later Date

49. If more than one comfort letter is requested, the later letter may, in appropriate situations, refer to information appearing in the earlier letter without repeating such information (see paragraph 9). Example C reaffirms and updates the information in example A.

July 25, 19X6

[Addressee]

Dear Sirs:

We refer to our letter of [date of example A] relating to the registration statement (no. 2-00000) of The Blank Company, Inc. We reaffirm as of the date hereof (and as though made on the date hereof) all statements made in that letter, except that, for the purposes of this letter,

1. The registration statement to which this letter relates is as amended as of July 13, 19X6 [effective date].
2. The reading of minutes described in paragraph 4 of that letter has been carried out through July 20, 19X6 [the new cutoff date].
3. The procedures and inquiries covered in paragraph 4 of that letter were carried out to July 20, 19X6 [the new cutoff date] (our work did not extend to the period from July 21, 19X6, to July 25, 19X6 [date of letter], inclusive).
4. The period covered in paragraph 4*b* of that letter is changed to the period from April 1, 19X6, to June 30, 19X6; officials of the company have advised us that the latest available financial statements are for the month of June 19X6.
5. The references to May 31, 19X6, in paragraph 5*b* of that letter are changed to June 30, 19X6.
6. The references to May 31, 19X6, and June 25, 19X6, in paragraph 6 of that letter are changed to June 30, 19X6, and July 20, 19X6, respectively.
7. This letter is solely for the information of, and assistance to, the underwriters in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the registration statement, and it is not to be used, circulated, quoted, or otherwise referred to within or without the underwriting group for any other purpose, including but not limited to the registration, purchase, or sale of securities, nor is it to be filed with or referred to in whole or in part in the registration statement or any other document, except that reference may be made to it in the underwriting agreement or in any list of closing documents pertaining to the offering of the securities covered by the registration statement.

Example D: Alternate Wording When SEC Has Agreed to a Departure From Its Published Accounting Requirements

50. Example D is applicable when (a) there is a departure from the applicable accounting requirements of the Act and the related published rules and regulations and (b) representatives of the SEC

have agreed to the departure. Numbered paragraph 2 of example A would be revised to read as follows:

In our opinion [include the phrase “except as disclosed in the registration statement,” if applicable], the financial statements and schedules examined by us and included or incorporated by reference in the registration statement comply in form in all material respects with the applicable accounting requirements of the Act and the related published rules and regulations; however, as agreed to by representatives of the SEC, separate parent-company financial statements and schedules as required by Rules 3-03 and 3-04 of Regulation S-X have been omitted.

Numbered paragraph 5a of example A would be revised in part to read as follows:

(i) . . . do not comply in form in all material respects with the applicable accounting requirements of the Act and of the related published rules and regulations; however, as agreed to by representatives of the SEC, separate parent-company financial statements and schedules as required by Rules 3-03 and 3-04 of Regulation S-X have been omitted; (ii) . . .

Example E: Alternate Wording When Recent Earnings Data Are Presented in Capsule Form

51. Example E is applicable when (a) the statement of income in the registration statement is supplemented by later information regarding sales and earnings (capsule information) and (b) the accountants are asked to comment on that information (paragraph 21). The same facts exist as in example A, except for the following:

1. Sales, net income (no extraordinary items), and earnings per share for the six-month periods ended June 30, 19X5 and 19X6 (both unaudited), are included in capsule form more limited than that specified by APB Opinion No. 28.
2. No statements later than those for June 19X6 are available.
3. The letter is dated July 25, 19X6, and the cutoff date is July 20, 19X6.

Numbered paragraphs 4, 5, and 6 of example A should be revised to read as follows:

4. For purposes of this letter we have read the 19X6 minutes . . . and have carried out other procedures to July 20, 19X6 (our work did not extend to the period from July 21, 19X6, to July 25, 19X6, inclu-

sive), with respect to the six-month periods ended June 30, 19X5 and 19X6, as follows:

- a. Read the unaudited consolidated condensed balance sheet as of March 31, 19X6, and the unaudited consolidated condensed statements of income, retained earnings, and changes in financial position for the three-month periods ended March 31, 19X6 and 19X5, included in the registration statement.
- b. Read the unaudited amounts for sales, net income, and earnings per share for the six-month periods ended June 30, 19X5 and 19X6, as set forth in the paragraph [identify location] and read the unaudited consolidated financial statements furnished us by the company for those periods, from which those amounts were derived.
- c. Made inquiries of certain officials of the company who have responsibility for financial and accounting matters regarding (i) whether the unaudited consolidated condensed financial statements referred to under *a* comply in form in all material respects with the applicable accounting requirements of the Act and the published rules and regulations thereunder, (ii) whether those unaudited consolidated condensed financial statements are fairly presented in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements included in the registration statement, and (iii) whether the unaudited amounts referred to under *b* are stated on a basis substantially consistent with that of the corresponding amounts in the audited consolidated statements of income.

The foregoing procedures do not constitute an examination made in accordance with generally accepted auditing standards. Also, they would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representations regarding the sufficiency of the foregoing procedures for your purposes.

5. Nothing came to our attention as a result of the foregoing procedures, however, that caused us to believe that

- a. (i) The unaudited consolidated condensed financial statements described in 4a, included in the registration statement, do not comply in form in all material respects with the applicable accounting requirements of the Act and the related published rules and regulations; or (ii) those unaudited consolidated condensed financial statements are not fairly presented in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements;
- b. The unaudited sales and net income amounts, referred to under 4b, (i) do not agree with the amounts set forth in the unaudited

consolidated financial statements for those same periods or (ii) were not determined on a basis substantially consistent with that of the corresponding amounts in the audited consolidated statements of income; or

- c. At June 30, 19X6, there was any change in the capital stock or long-term debt of the company and subsidiaries consolidated or any decreases in consolidated net current assets or net assets as compared with amounts shown in the March 31, 19X6, unaudited consolidated condensed balance sheet included in the registration statement, except for changes or decreases that the registration statement discloses have occurred or may occur.

6. Company officials have advised us that no consolidated statements as of any date or for any period subsequent to June 30, 19X6, are available; accordingly, the procedures carried out by us with respect to changes in financial-statement items after June 30, 19X6, have, of necessity, been even more limited than those with respect to the periods referred to in 4. We have made inquiries of certain company officials who have responsibility for financial and accounting matters regarding whether (i) at July 20, 19X6, there was any change in the capital stock or long-term debt of the company and subsidiaries consolidated or any decreases in consolidated net current assets or net assets as compared with amounts shown on the March 31, 19X6, unaudited consolidated condensed balance sheet included in the registration statement; or (ii) for the period from July 1, 19X6, to July 20, 19X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in the total or per-share amounts of income before extraordinary items or of net income. On the basis of these inquiries and our reading of the minutes as described in 4, nothing came to our attention that caused us to believe that there was any such change or decrease, except in all instances for changes or decreases that the registration statement discloses have occurred or may occur.

Example F: Alternate Wording When Accountants Are Aware of a Decrease in a Specified Financial-Statement Item

52. Example F covers a situation in which the accountants are aware of a decrease in a financial-statement item on which they are requested to comment (paragraphs 23 through 28). The same facts exist as in example A, except for the decrease covered in the following change in numbered paragraph 5b.

- b. (i) At May 31, 19X6, there was any change in the capital stock or long-term debt of the company and subsidiaries consolidated or any decrease in consolidated net assets as compared with amounts shown in the March 31, 19X6, unaudited consolidated condensed balance sheet included in the registration statement; or (ii) for the period from April 1, 19X6, to May 31, 19X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or the total or per-share amounts of income before extraordinary items or net income, except in all instances for changes or decreases that the registration statement discloses have occurred or may occur, except that the unaudited consolidated balance sheet as of May 31, 19X6, which we were furnished by the company, showed a decrease from March 31, 19X6, in consolidated net current assets as follows (in thousands of dollars):

	<i>Current Assets</i>	<i>Current Liabilities</i>	<i>Net Current Assets</i>
March 31, 19X6	\$4,251	\$1,356	\$2,895
May 31, 19X6	3,986	1,732	2,254

6. As mentioned under 4*b*, company officials have advised us that no consolidated statements as of any date or for any period subsequent to May 31, 19X6, are available; accordingly, the procedures carried out by us with respect to changes in financial-statement items after May 31, 19X6, have, of necessity, been even more limited than those with respect to the periods referred to in 4. We have made inquiries of certain company officials who have responsibility for financial and accounting matters regarding whether (i) there was any change at June 25, 19X6, in the capital stock or long-term debt of the company and subsidiaries consolidated or any decreases in consolidated net current assets or net assets as compared with amounts shown on the March 31, 19X6, unaudited consolidated condensed balance sheet included in the registration statement; or (ii) for the period from April 1, 19X6, to June 25, 19X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in the total or per-share amounts of income before extraordinary items or of net income. On the basis of these inquiries and our reading of the minutes as described in 4, nothing came to our attention that caused us to believe that there was any such change or decrease, except in all instances for changes or decreases that the registration statement discloses have occurred or may occur and except as described in the following sentence. We have been informed by officials of the company that there continues to be a decrease in net current assets that is estimated to be approximately the same amount as set forth in 5*b* [or whatever other disclosure fits the circumstances].

Example G: Alternate Wording When Accountants' Opinion Contains a Qualification

53. Example G is applicable when the accountants' opinion on the audited financial statements included in the registration statement contains a qualification regarding a matter that may also affect the unaudited consolidated condensed financial statements included in the registration statement. The introductory paragraph in example A would be revised as indicated in paragraph 30. The following would be substituted for numbered paragraph 5*a* in example A.

- a.* Subject to the effects of adjustments that might have been required had the outcome of the uncertainty discussed in Note 3 to the consolidated financial statements (which resulted in the qualification of our opinion, as referred to in the introductory paragraph of this letter) been known, (i) the unaudited consolidated condensed financial statements described in 4*a*(i) . . .

The possible effect of the qualification should also be evaluated to determine whether it also requires mention in the comments on subsequent changes (numbered paragraph 5*b* of example A). This might occur if the relative possible effect on net income of the matter to which the qualification relates is increasing.

Example H: Alternate Wording When More Than One Accountant Is Involved

54. Example H applies when more than one accountant is involved in the examination of the financial statements of a business and the principal accountants have obtained a copy of the comfort letter of the other accountants (paragraph 35). Example H consists of an addition of a subparagraph *c* to numbered paragraph 4, a substitution for the applicable part of numbered paragraph 5, and an addition to numbered paragraph 6 of example A.

- [4]*c.* We have read the letter dated _____ of [the other accountants] with regard to [the related company].

5. Nothing came to our attention as a result of the foregoing procedures (which, so far as [the related company] is concerned, consisted solely of reading the letter referred to in 4*c*), however, that caused us to believe that. . .

6. . . . On the basis of these inquiries and our reading of the minutes and the letter dated _____ of [the other ac-

countants] with regard to [the related company], as described in 4, nothing came to our attention that caused us to believe that there was any such change or decrease, except in all instances for changes or decreases that the registration statement discloses have occurred or may occur.

Example I: Comments on Tables, Statistics, and Other Financial Information

55. Example I is applicable when the accountants are asked to comment on tables, statistics, or other compilations of information appearing in a registration statement (paragraphs 38 through 43). Each of the comments is in response to a specific request. The paragraphs in example I are intended to follow numbered paragraph 6 in example A.

7. For purposes of this letter, we have also read the following, set forth in the registration statement on the indicated pages.²⁰

<u>Item</u>	<u>Page</u>	<u>Description</u>
<i>a</i>	4	"Capitalization." The amounts under the captions "Amount Outstanding as of June 15, 19X6" and "As Adjusted." The related notes, except the following in Note 2: "See 'Transactions With Interested Persons.' From the proceeds of this offering the company intends to prepay \$900,000 on these notes, pro rata. See 'Use of Proceeds.'"
<i>b</i>	13	"History and Business—Sales and Marketing." The table following the first paragraph.
<i>c</i>	22	"Remuneration of Management—19X5 Remuneration." The dollar amounts shown at the top of the page under the headings "Cash and Cash-Equivalent Forms of Remuneration—Salaries, Commissions and Bonuses and Securities, Insurance Benefits, Personal Benefits" and "Aggregate of Contingent Forms of Remuneration."

²⁰In some cases it may be considered desirable to combine in one paragraph the substance of paragraphs 7 and 9. This may be done by expanding the identification of items in paragraph 9 to provide the identification information contained in paragraph 7. In such cases, the introductory sentences in paragraphs 7 and 9 and the text of paragraph 8 might be combined as follows:

For purposes of this letter, we have also read the following information and have performed the additional procedures stated below with respect to such information. Our examination of the consolidated financial statements . . .

<i>Item</i>	<i>Page</i>	<i>Description</i>
<i>d</i>	33	"Selected Financial Data." ²¹ The amounts of net sales, income from continuing operations, income from continuing operations per common share, total assets, long-term obligations, redeemable preferred stock, and cash dividends declared per common share for each of the five years in the period ended December 31, 19X5.

8. Our examination of the consolidated financial statements for the periods referred to in the introductory paragraph of this letter comprised audit tests and procedures deemed necessary for the purpose of expressing an opinion on such financial statements taken as a whole. For neither the periods referred to therein nor any other period did we perform audit tests for the purpose of expressing an opinion on individual balances of accounts or summaries of selected transactions such as those enumerated above, and, accordingly, we express no opinion thereon.

9. However, for purposes of this letter we have performed the following additional procedures, which were applied as indicated with respect to the items enumerated above:

<i>Item in 7</i>	<i>Procedures and Findings</i>
<i>a.</i>	We compared the amounts and numbers of shares listed under the caption "Amount Outstanding as of June 15, 19X6" with the balances in the appropriate accounts in the company's general ledger at May 31, 19X6 (the latest date for which postings had been made), and found them to be in agreement. We were informed by officials responsible for financial and accounting matters that there had been no changes in such amounts and numbers of shares between May 31, 19X6, and June 15, 19X6. We compared the amounts and numbers of shares listed under the caption "Amount Outstanding as of June 15, 19X6" adjusted for the issuance of the debentures to be offered by means of the registration statement and for the proposed use of a portion of the proceeds thereof to prepay portions of certain notes, as described under "Use of Proceeds," with the amounts and numbers of shares shown under the caption "As Adjusted" and found such amounts and numbers of shares to be in agreement. (However, we make no comments regarding the reasonableness of the "Use of Proceeds" or whether such use will actually take place.) We com-

²¹In some cases the company or the underwriters may request that the independent accountants cover the "selected financial data" in their auditors' report. When the auditors' report specifically covers this data, separate comments should not be included in the comfort letter.

*Item
in 7**Procedures and Findings*

- pared the description of the securities and the information (except certain information in Note 2, referred to in 7) included in the notes to the table with the corresponding descriptions and information in the company's consolidated financial statements, including the notes thereto included in the registration statement, and found such descriptions and information to be in agreement.
- b. We compared the amounts of military sales, commercial sales, and total sales shown in the registration statement with the balances in the appropriate accounts in the company's general ledger for the respective fiscal years and for the unaudited interim periods and found them to be in agreement. (However, we make no comments regarding the appropriateness of such classification or the manner in which such classification has been made.) We computed the approximate percentages of such amounts of military sales and commercial sales to total sales for the respective fiscal years and for the unaudited interim periods. We compared the computed percentages with the corresponding percentages appearing in the registration statement and found them to be in agreement.
- c. We compared the dollar amounts of cash remuneration for salaries, commissions, and bonuses for each listed individual with the corresponding amounts shown by the individual employee earnings records for the year 19X5 and found them to be in agreement. We compared the dollar amount of aggregate directors' and executive officers' cash remuneration for salaries, commissions, and bonuses with the corresponding amount shown in an analysis prepared by the company and found the amounts to be in agreement.
- We compared the dollar amounts of cash-equivalent forms of remuneration—securities, insurance benefits, personal benefits, and aggregate contingent forms of remuneration for each listed individual and the aggregate amounts for directors and executive officers with corresponding amounts shown in an analysis prepared by the company and found such amounts to be in agreement. However, we make no comment regarding the completeness or appropriateness of the company's determination of what constitutes management remuneration for purposes of the SEC disclosure requirements on management remuneration.
- d. We compared the amounts of net sales, income from continuing operations, income from continuing operations per common share, and cash dividends declared per common share for the years ended December 31, 19X5, 19X4, and 19X3, to the consolidated financial statements on pages 27 and 28 and the amounts for the years ended December 31, 19X2 and 19X1, to the financial state-

*Item
in 7**Procedures and Findings*

ments included in the company's annual reports to stockholders for 19X2 and 19X1 and found them to be in agreement.

We compared the amounts of total assets, long-term obligations, and redeemable preferred stock at December 31, 19X5 and 19X4, with the consolidated financial statements on pages 27 and 28 and the amounts at December 31, 19X3, 19X2, and 19X1, to the corresponding amounts in the consolidated financial statements included in the company's annual reports to stockholders for 19X3, 19X2, and 19X1, and found them to be in agreement.

10. It should be understood that we make no representations regarding questions of legal interpretation or regarding the sufficiency for your purposes of the procedures enumerated in the preceding paragraph; also, such procedures would not necessarily reveal any material misstatement of the amounts or percentages listed above. Further, we have addressed ourselves solely to the foregoing data as set forth in the registration statement and make no representations regarding the adequacy of disclosure or regarding whether any material facts have been omitted.

11. This letter is solely for the information of, and assistance to, the underwriters in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the registration statement, and it is not to be used, circulated, quoted, or otherwise referred to within or without the underwriting group for any other purpose, including but not limited to the registration, purchase, or sale of securities, nor is it to be filed with or referred to in whole or in part in the registration statement or any other document, except that reference may be made to it in the underwriting agreement or in any list of closing documents pertaining to the offering of the securities covered by the registration statement.

Example J: Letter When a Short-Form S-16 Registration Statement Is Filed Incorporating Previously Filed Forms 10-K and 10-Q by Reference

56. Example J is applicable when a registrant uses Form S-16, the short-form registration statement, which, by reference, incorporates previously filed Forms 10-K and 10-Q. It assumes that the Form S-16 registration statement and prospectus include the Form 10-K for the year ended December 31, 19X5, and Form 10-Q for the quarter ended March 31, 19X6, which have been incorporated by reference. In addi-

tion to the information presented below, the letter would also contain paragraphs 6 and 7 of the typical letter in example A.

June 30, 19X6

[Addressee]

Dear Sirs:

We have examined the consolidated balance sheets of the Blank Company (the company) and subsidiaries as of December 31, 19X5 and 19X4, and the related consolidated statements of income, retained earnings, and changes in financial position for each of the three years in the period ended December 31, 19X5, and the related schedules, all included [or incorporated by reference] in the company's annual report on Form 10-K for the year ended December 31, 19X5, and incorporated by reference in the registration statement (no. 2-00000) on Form S-16 filed by the company under the Securities Act of 1933 (the Act); our report with respect thereto is also incorporated by reference in the registration statement and prospectus. The registration statement, as amended on May 31, 19X6, and the company's prospectus dated May 31, 19X6, are herein referred to as the registration statement and the prospectus respectively.

In connection with the registration statement and prospectus

1. We are independent public accountants with respect to the company within the meaning of the Act and the applicable published rules and regulations thereunder, and the answer to item 10 of the registration statement is correct insofar as it relates to us.

2. In our opinion, the consolidated financial statements and schedules examined by us and incorporated by reference in the registration statement and prospectus comply in form in all material respects with the applicable accounting requirements of the Act and the Securities Exchange Act of 1934 and the related published rules and regulations.

3. We have not examined any financial statements of the company as of any date or for any period subsequent to December 31, 19X5. Although we have made an examination for the year ended December 31, 19X5, the purpose (and therefore the scope) of such examination was to enable us to express our opinion on the consolidated financial statements as of December 31, 19X5, and for the year then ended, but not on the consolidated financial statements for any interim period within that year.

Therefore, we are unable to and do not express any opinion on the unaudited consolidated condensed balance sheet as of March 31, 19X6, and the unaudited consolidated condensed statements of income, retained earnings, and changes in financial position for the three-month periods ended March 31, 19X6 and 19X5, included in the company's quarterly report on Form 10-Q for the quarter ended March 31, 19X6, incorporated by reference in the registration statement and prospectus, or on the financial position, results of operations, or changes in finan-

cial position as of any date or for any period subsequent to December 31, 19X5.

4. For purposes of this letter, we have read the 19X6 minutes of the meetings of the stockholders, board of directors, and [include other appropriate committees, if any] of the company and its subsidiaries as set forth in the minute books at June 25, 19X6, company officials having advised us that the minutes of all such meetings through that date were set forth therein, and have carried out other procedures to June 25, 19X6 (our work did not extend to the period from June 26, 19X6, to June 30, 19X6, inclusive), as follows:

- a. With respect to the three-month periods ended March 31, 19X6 and 19X5, we have
 - i. Read the unaudited consolidated condensed financial statements for these periods, described in 3, included in the company's quarterly report on Form 10-Q for the quarter ended March 31, 19X6, incorporated by reference in the registration statement and prospectus.
 - ii. Made inquiries of certain company officials who have responsibility for financial and accounting matters regarding (1) whether the unaudited consolidated condensed financial statements comply in form in all material respects with the applicable accounting requirements of the Securities Exchange Act of 1934 as it applies to Form 10-Q and the related published rules and regulations and (2) whether those unaudited consolidated condensed financial statements are presented in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements incorporated by reference in the registration statement and prospectus.
- b. With respect to the period from April 1, 19X6, to May 31, 19X6, we have
 - i. Read the unaudited consolidated financial statements of the company and subsidiaries for April and May of both 19X5 and 19X6 furnished us by the company, officials of the company having advised us that no such financial statements as of any date or for any period subsequent to May 31, 19X6, were available; and
 - ii. Made inquiries of certain company officials who have responsibility for financial and accounting matters regarding whether the unaudited financial statements referred to under b(i) are stated on a basis substantially consistent with that of the audited consolidated financial statements incorporated by reference in the registration statement and prospectus.

The foregoing procedures do not constitute an examination made in accordance with generally accepted auditing standards. Also, they would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no

representations about the sufficiency of the foregoing procedures for your purposes.

5. Nothing came to our attention as a result of the foregoing procedures, however, that caused us to believe that

- a. (i) The unaudited consolidated condensed financial statements described in 3, incorporated by reference in the registration statement and prospectus, do not comply in form in all material respects with the applicable accounting requirements of the Securities Exchange Act of 1934 as it applies to Form 10-Q and the related published rules and regulations; or (ii) those unaudited consolidated condensed financial statements are not presented in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements incorporated by reference in the registration statement and prospectus; or
- b. (i) At May 31, 19X6, there was any change in the capital stock or long-term debt of the company and subsidiaries consolidated or any decreases in consolidated net current assets or net assets as compared with amounts shown in the March 31, 19X6, unaudited consolidated condensed balance sheet incorporated by reference in the registration statement and prospectus; or (ii) for the period from April 1, 19X6, to May 31, 19X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in the total or per-share amounts of income before extraordinary items or of net income, except in all instances of changes or decreases that the registration statement and prospectus disclose have occurred or may occur.

The Statement entitled Letters for Underwriters was adopted by the assenting votes of fifteen members of the board, of whom Mr. Betts assented with qualification.

Mr. Betts approves issuance of this Statement but qualifies his assent with respect to paragraphs 18 and 39 because he does not agree that an independent accountant should give negative assurance on unaudited financial information to underwriters without having previously audited financial statements of the entity. He believes that without an audit base, the risk to the accountant is too great with respect to conditions or matters on which the accountant is providing negative assurance.

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